1812

THE NATIONAL CITY BANK OF NEW YORK

1938

Economic Conditions
Governmental Finance
United States Securities

New York, June, 1938

General Business Conditions

THE slackening in trade and industrial activity during May signifies that the Spring season is drawing to an early close, without much to look back upon in the way of seasonal pickup. Reports from the industries have continued disappointing, and the composite indexes of industrial production for the month are expected to be slightly lower than in March and April, when the Federal Reserve Board's index was 79 and 77, respectively. The drop is small, but nevertheless influences sentiment, for when the Spring closes on a disappointing note the Summer is likely to be dull. The markets show that business men are not expecting much change for the better at least until seasonal influences again turn favorable, which will be in late August or September.

The sluggishness of the Spring season has been largely a reflection of the poor automobile business. With domestic passenger car sales running less than half of last year's total, and truck sales down almost as much, production has tapered off earlier than usual. The total in April (U. S. and Canada) was 238,000 vehicles, compared with 550,000 in the same month last year, and the May figure will be still lower. Unless sales have an unexpected pickup assemblies will drop to extremely low levels during the next two or three months.

Steel mill operations have receded slowly, dropping below 30 per cent of capacity for the first time since January. New orders for steel have slackened as usual at this season, despite the small business placed earlier. Reaffirmation of present prices for the third quarter has not stimulated buying. Many business men have felt that a decline in steel prices would be helpful to the general situation, since it would mean lower costs to many industries. However, steel men reply that they cannot possibly reduce prices, with operations at their present level, unless they could reduce wages also; and they are evidently not ready to propose this at present.

Textile markets have all been sluggish. Buying of Fall woolens for men's wear has been poor, and at this late date there is no hope of anything but a belated spurt. Cotton mills have had but few days of good business, their inventories are large, and curtailment will continue heavy. Rayon yarn prices have been cut to new lows, with mill operations around 55 per cent of capacity and yarn stocks good-sized. Textile curtailment is now so great that it is certain to bring its own corrective, possibly in the buying season for Fall goods.

In the heavy industries, especially industrial equipment of all kinds, buying is slow, backlogs are being reduced, and the trend of operations is downward. Machine tool orders in April were less than one-third of last April's total. Building contract awards were disappointing in April, but have improved in May; residential awards in the first three weeks made a sharp contra-seasonal gain over the preceding month, and totaled slightly more than a year ago. This is an encouraging showing, considering the general state of business and the high building costs.

Commodity Prices at New Lows

The continued weakening of commodity prices has been the most depressing influence in the situation. Indexes of staple commodities have dropped to new lows. Non-ferrous metal prices, which are sensitive to general business conditions, have all been marked down, and the textile fibers have weakened. Wheat has drifted lower, and many of the tropical products have dropped considerably.

The chief cause of the commodity weakness is plainly lack of demand. Many manufacturers are still well supplied with materials, considering their present low requirements, and those who have to buy for current needs see little inducement to go beyond them. The idea that inflationary monetary policies and Government spending favor a long-term upward trend in commodity prices obviously is playing small part in practical business decisions.

While the unwillingness to buy ahead is depressing it is the natural policy under the conditions, and the natural policy is usually soundest in the long run. Everyone is anxious to see prices turn upward once more, but a

commodity buying movement could not last long unless it were supported by increased industrial operations, sales and consumption; and business men have good reason to know that it is hazardous to try to beat the gun. Where the improvement should begin is in the general economic situation. When inventories are cut down, costs reduced, prices brought into line and profits restored, and business men have more incentive to go ahead with plans and projects, business will pick up; demand for commodities will resume; and price recovery will begin in a normal and healthy way. Meanwhile the prevailing policy of working off inventories and staying close to shore on commitments, together with the endless effort to increase efficiency and cut costs, is strengthening the situation. Unquestionably measures of this kind will do more to brighten the Fall prospect than anything else individuals can do.

Little Stimulus from Spending Program

The Administration's monetary-spending program, announced in April, has made little impression up to this time, except in one respect. It has strengthened the high grade bond market, and this is leading to a revival of new security offerings. The industrial issues in prospect are chiefly for refunding purposes (the U. S. Steel Corporation $100,000,000 issue, half of which is entirely new money, is an exception), and are confined to the highest grade borrowers; whereas the need is for a market which will supply new money for enterprises which include an element of risk. Nevertheless the opening of the capital markets in any respect is an important change for the better. It relieves anxiety as to maturities, and makes it less imperative for corporations to conserve cash; and refunding debts at lower rates reduces fixed charges and overhead costs. Moreover, the advance in high grades reinforces the position of the investment portfolios of institutions. The strength of the banking system is of incalculable value in supporting the economic situation, in contrast to the last depression, when banking weakness and liquidation kept the deflation going.

The failure of the Administration's announcement to stimulate trade and industrial activity is evidence that trade and industry are not yet ready to move forward on their own account, and until they are ready psychological stimulants are not likely to be effective. It cannot be repeated too often that the program is only one of many factors in the business situation; also that there are strong differences of opinion as to whether private business is likely to be encouraged or discouraged by it. Of course the actual new spending, which is still to be passed upon by Congress, is not yet under way. It will not put new purchasing power into consumers' hands until the money goes out, and this will be slow. Public works and naval expenditures require time to get started, and relief disbursements cannot be vastly increased at once because they are already huge.

Looking ahead, it is hard to say whether the spending will be counter-balanced by deflationary influences, or whether it will coincide with the natural upturn and thereby accelerate it. There is strong hope it will take the latter course, and good arguments can be marshalled to support the hope. Not only is the monetary policy designed to expand credit, and the Government turned into a spender, but there will be accumulated needs for goods by Fall. The new tax law is substantially less punitive with respect to undistributed earnings and capital gains, and thus is more encouraging to enterprise. The markets have given some evidence of opinion that the public utility outlook is better, on the ground that progress is being made toward settling public and private differences on a basis which will make forward planning feasible.

Moreover, there is testimony that with the passage of time industrial efficiency is being increased and costs lowered. This is what depressions accomplish,—they eliminate the wastes and maladjustments and correct the miscalculations which made the preceding boom unsupportable. There is evidence that labor cost per unit of output is now being lowered in many lines through increased output per man hour and, in textiles, shoes and a number of other industries, through wage cuts. Unit costs rose rapidly early in the depression, due to the decline in volume, but on the comparatively stable operating levels of the past few months they have been reduced again.

All this represents progress. But the outlook is not clean-cut, the bullish factors are qualified by others and are not impressing sentiment very forcefully; and, whatever their opinions, business men are not prejudging the outcome.

The Inventory Situation

Unquestionably inventories are being worked down, but in many instances they are still too large to warrant expectation of early production increases. The fact that stocks of goods held by manufacturers and distributors at the 1937 peak were close to record figures has been brought out by estimates made recently. Dun's Review for May, published by Dun & Bradstreet, includes a voluminous survey (examining more than 42,000 statements) from which it is concluded that manufacturers' inventories increased 20 per cent during 1937, against a sales gain of 14 per cent. Wholesalers' inventories rose 12 per cent, the same as their sales increase; and retailers' stocks increased 10 per cent, while sales were up 8. In dollars, the total rise during 1937 was $3 billion, and this followed an increase of more than $2 billion in 1936. The sharp decline in sales made these inventories a heavy burden, requiring a long time to work off.

This refers to some months past, and the question now is how rapidly are stocks being cut. Relatively few corporations give inventory figures in their quarterly statements, but the following table includes 75 leading companies, and summarizes their inventory position as of March 31. As compared with December 31 the totals are 10.1 per cent lower, and as compared with March 31, 1937 they are 2.3 per cent lower. Excluding General Motors and Chrysler, the two largest corporations on the list, the reduction during the first quarter was only 5 per cent, and as compared with the previous year there was an increase of 5.8 per cent.

Inventories of Leading Corporations on March 31, 1938, And Changes During the Quarter and Year

No.	Industry	Total March 31, 1938	Percentage Change During Quarter	Percentage Change During Year
5	Automobiles	$301,803	—14.3	— 9.3
8	Auto Accessories	31,120	—10.9	+ 8.2
6	Building Materials	7,417	— 6.7	+ 0.3
7	Chemicals	23,865	— 0.2	+ 7.6
2	Dairy Products	4,036	—14.2	— 9.1
4	Electrical Equipment	4,463	— 5.0	+11.4
3	Heating and Plumbing	5,184	— 2.8	—14.6
7	Machinery	51,652	— 4.3	+21.9
2	Merchandising	5,593	— 4.7	— 1.0
6	Metals	36,729	+ 1.6	+18.1
1	Petroleum	23,796	+ 0.8	+ 4.2
2	Railway Equipment	22,627	— 7.0	—11.2
4	Textiles	6,381	—12.0	— 5.8
18	Misc. Manufacturing	33,823	— 7.3	+ 5.5
75	Companies	$558,489	—10.1	— 2.3
73	Companies, excluding General Motors and Chrysler Corp.	277,658	— 5.0	+ 5.8

Of the 75 companies 54 had lower inventories than on December 31, while in 21 cases stocks were larger. The increases reflect deliveries received since the year-end on commitments made earlier. However, commitments on March 31 were undoubtedly low, and the total of stocks on hand plus commitments would show a more favorable situation than is indicated by the above figures. As the decline in commitments is reflected, inventory figures will drop more rapidly, and almost certainly the June 30 reports will make a better showing.

All the evidence is that production of finished and semi-finished goods has been running below consumption for some time. This is common observation, and it is supported by such statistical comparisons as can be made. Thus department store sales during May have run 14 per cent below last year in dollars, mail order sales are down about the same, variety stores slightly less. Probably one-half of the drop reflects lower prices, and the decline in the volume of general merchandise sold is therefore around 7 per cent. By contrast, the Standard Statistics index of production of consumers' goods is down 28 per cent, merchandise and l.c.l. car loadings are off 13 per cent, and shipments by motor truck, judging by partial figures, are something like 20 per cent lower. After allowing for over-production last year, these discrepancies represent substantial reductions in stocks. Department store inventories were down 10 per cent at the end of April, and have little further to decline before reaching the plateau which they held for a long period prior to the latter half of 1936.

It is safe to say that total stocks of steel in the country have been sharply reduced, since the curtailment in steel output has been much greater than that in the steel-consuming industries. Probably the same applies to many other lines.

In summarizing manufacturers' inventories, the best opinion is that they would not now block trade and price improvement if other elements in the situation were stimulating; but under the circumstances they are restricting production, and will do so for some time yet. By Fall the way will be cleared in many channels for resumption of buying. But whether buying continues upon a hand to mouth basis or moves ahead more confidently will depend upon conditions then. In any event production must recover to the level of consumption, and in consumers' goods at least, where consumption is supported by Government disbursements, this should bring an increase in operations.

Crop Prospects Good, Farm Income Lower

Farmers have prospects of good crops this year, but will have to rely heavily upon Government payments and price-supporting loans to keep their income up. Prices of farm products average between 25 and 30 per cent below a year ago. On April 15 the ratio of prices received to prices farmers pay was down to 75, compared with the recovery high of 101. This declining ratio signifies a disparity between farm and industrial prices which, to the extent that it carries over into income, reduces the farmers' purchasing power. However, farm income is not down as greatly as average prices, largely because of increased sales of dairy products. April cash income was 15 per cent under last year. Government payments during the next few months will be materially larger than in the same period of 1937, and the seasonal increase in marketings will as usual provide the farmers with more money than in the months just past. Hence farm income reports are not likely to get worse.

The wheat crop will be phenomenal if present prospects are realized. The May 1 estimate of Winter wheat was 754,000,000 bushels, and Spring wheat, which has a good start, should yield 200,000,000 or more with fair growing conditions. Adding the 200,000,000 carryover from the present season, the total is more than this country or our customers abroad are likely to want, especially as Canada also has a brilliant prospect. Therefore Government loans will be employed to support the market, as provided in the new Farm Act. Loans are mandatory if the farm price on June 15 is below 52

per cent of "parity", or about 60 cents; or if the July crop estimate is above normal requirements, figured at about 700,000,000 bushels. Whether the farm price will be below 60 cents June 15 is touch and go, but loans are certain under the second provision. They can be anywhere between 60 and 86 cents on the farm, but obviously must be at the lower price if we hope to export wheat this year.

Cotton has made a late but otherwise fair start. Cotton loans also will be mandatory if the price on August 1 is below about 8.32 cents, average in ten Southern markets; or if the August crop estimate is above normal consumption and exports, about 13,000,000 bales. The cotton price recently has broken away from the peg provided by the present 9 cent loan, and is under 8 cents, despite the fact that the Government is holding 7,000,000 bales off the market. The crop this year, if yields are average, will be little if any in excess of needs, but the prospect offers little hope of relieving the Government of any of its holdings.

The problem of disposing of the Government cotton stock without letting the price down to a level which will discourage foreign production seems insoluble. Yet the Government this year will embark on the same course in the wheat market. If it can compel or persuade a cut in next year's wheat acreage by 35 to 40 per cent, as it wishes, the statistical position would probably be balanced once more. But the other part of the problem is: who will stop growing wheat, and what will they do, other than look to the Government for support?

Money and Banking

The process of pumping additional cash into the already abundant reserves of the banks, begun in April, was continued in May. Following the huge expansion of excess reserves created by the lowering of reserve requirements in April, actual reserves of member banks rose further in May to a new all-time high, while the surplus of reserves over and above legal requirements touched $2,630,000,000 on the 25th, a new high since reserve requirements were first advanced in August, 1936. For the New York City member banks alone, excess reserves reached $1,184,000,000, likewise a new high since August, 1936.

The principal cause of the growth of excess reserves was the expenditure by the Treasury of the proceeds of desterilized gold which had been transferred to the Federal Reserve Banks when the inactive gold account was abolished in April. Since then the Treasury has been using this money to pay its running expenses, including relief, and for redemption of $50,000,000 of Treasury bills weekly since April 27. As a result, the Treasury's huge balances at the central bank have been whittled down from a peak of $1,429,000,000 on April 20 to $1,183,000,000 on May 25. That the decrease was not greater in the face of the Treasury's heavy spending was due to various offsetting receipts, including quarterly payments of social security taxes and cash subscriptions to Commodity Credit Corporation notes sold early in May. Also, a minor influence was the action of some banks in surrendering Government deposits in order to reduce Federal Deposit Insurance Corporation assessments.

In the four charts at the foot of the page we trace the several steps by which gold is desterilized and the proceeds incorporated into commercial bank reserves.

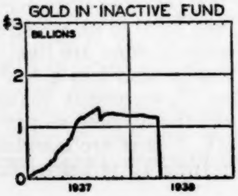
The Process of Gold Desterilization

By way of preliminary it should perhaps be restated that during the period of gold sterilization, metal purchased by the Treasury, either from foreign or domestic sources, was paid for with funds raised by the sale of securities in the open market instead of, as previously, by deposit of gold certificates in the Federal Reserve Banks. Handled in this way, the gold, as shown in the second and fourth charts, did not during this period enter into the reserves of either the Reserve Banks or the commercial banks,—hence was "sterilized" in the sense of being unavailable for use as a basis of credit.*

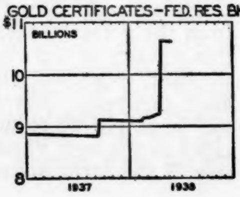
When the Treasury abolished the inactive gold account (chart 1), it credited the gold certificate fund of the Federal Reserve Banks (chart 2) with an equivalent amount, (plus approximately $200,000,000, covering a residuum of "free" gold held in the Treasury since revaluation of the gold stock in 1934). The issuance of gold certificates to the Federal Reserve Banks provided the Treasury with additional deposit balances in the central institutions (chart 3), the expenditure of which over coming months will add further to member bank reserves (chart 4), already up substantially since the first of the year, owing partly to

*Desterilization of $300,000,000 of gold last September reflected by drop in inactive gold account and rise in reserves of Federal Reserve Banks and member banks at that time.

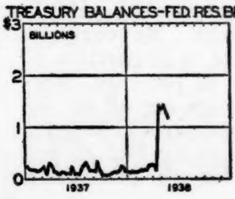
GOLD IN INACTIVE FUND



GOLD CERTIFICATES-FED. RES. BKS.



TREASURY BALANCES-FED. RES. BKS.



MEMBER BANK RESERVES

seasonal redeposit of currency in January and the beginning of Treasury disbursements of proceeds of desterilized gold in April.

Apart from Treasury transactions, commercial bank reserves were augmented during May by an increase of $45,000,000 in the monetary gold stock, carrying the total gold holdings of the country to a new high record of $12,905,000,000. With Japan continuing to ship gold to us in settlement of adverse trade balances, and with European exchanges under renewed pressure as a result of developments in Central Europe, it looks as though United States' gold holdings will soon exceed the thirteen billion mark.

Trend of Member Bank Credit

Notwithstanding the growth of excess reserves in recent months, the decline in earning assets of commercial banks appears to have gone on unchecked. Total loans and investments of the weekly reporting banks in 101 principal cities reached on May 18 a new low point since 1935.

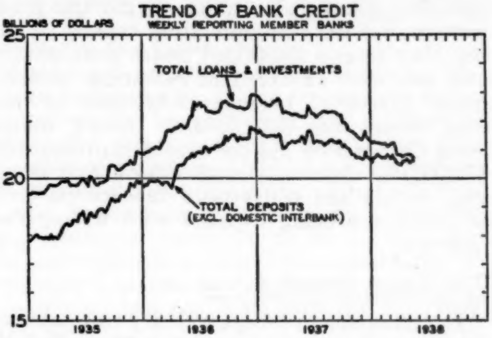
The decline during the latter part of April and first half of May was caused principally by the further repayment of loans, and by the policy of the Treasury in retiring Treasury bills. Loans to brokers and dealers in securities receded during the period, and on May 18 were $800,000,000 below the peak reached last September. This showing is paralleled by the report of the New York Stock Exchange revealing a total of member borrowings May 1 of $466,000,000, compared with $1,186,000,000 on September 1, last, and $8,549,000,000 at the all-time peak reached on October 1, 1929. Loans of the reporting banks for commercial, industrial and agricultural purposes likewise decreased to a new depression low, off approximately $800,000,000 since the high point of last Autumn. Holdings of United States Government guaranteed issues increased substantially, but a drop in holdings of "other securities", coupled with the Treasury bill redemptions, prevented any material gain in aggregate investments.

Deposits of reporting banks increased in recent weeks, mainly as a result of payments by the Treasury out of its balances with the Reserve Banks. As shown by the accompanying chart, deposits other than interbank have held up better than loans and investments this year, while interbank deposits, not shown in the chart, have increased substantially.

Vanishing Money Rates

Open market short-term money rates continue largely nominal, with the sensitive short-term Treasury bill rate down to the fantastic figure of 0.025 per cent. Probably no interest rate as low as this has ever been quoted anywhere before. Compared with this even the ½ of 1 per cent obtainable on British and

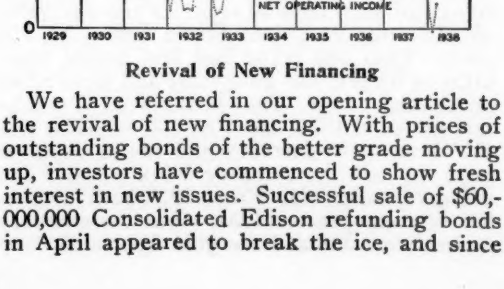
TREND OF BANK CREDIT



Canadian Treasury bills seems generous. Evidence also of the extraordinary monetary conditions prevailing appeared in the Treasury note market, where maturities up to September 15, 1939, were quoted at the end of May on a no-yield basis, investors being willing to hold them for possible conversion privileges. Maturities as far away as 1942 bring little better than ¾ of 1 per cent.

In the bond market, United States Government issues were generally strong, with both issues of the Treasury 2½s and certain of the guaranteed obligations reaching new high levels. In the corporate list, high grade utilities and industrials were in good demand, but rails were easier, particularly junior liens which lost a substantial part of their recent recovery, due to continued poor earnings and absence of any constructive program for dealing with the railway problem. With railway net operating income thus far this year slumped below the levels even of 1932, average yields on representative medium grade rail bonds (Moody's Baa) are now around 10 per cent, as against 5 per cent a year ago, while numerous rail bonds of lesser grade are quoted under 1932 prices.

RAILROAD BOND YIELDS AND NET OPERATING INCOME



Revival of New Financing

We have referred in our opening article to the revival of new financing. With prices of outstanding bonds of the better grade moving up, investors have commenced to show fresh interest in new issues. Successful sale of $60,000,000 Consolidated Edison refunding bonds in April appeared to break the ice, and since

then the volume of activity, actual and prospective, has been accumulating rapidly. During May several important issues were offered and met with an excellent reception. Among major pieces of business scheduled for the near future are $100,000,000 United States Steel Corporation 3¼ per cent debentures, and $73,000,000 Commonwealth Edison first mortgage bonds and convertible debentures, both of which are being awaited with widespread interest.

The Latest French Crisis

Ten months ago (August, 1937) this publication carried an article headed "The French Financial Crisis." One year earlier (October and November, 1936) it discussed "The French Devaluation" and the "Tripartite Agreement," the latter a compact between France, Great Britain and the United States for the maintenance of a parity of exchange relations. Eleven years earlier (August, 1926) it gave a nine page discussion entitled "The French Financial Crisis," supplemented by comments in July, 1928, upon "The French Monetary Reform." These articles have described the troubled state of French money and finance from the Great War down to last year.

The French currency has not been the only currency in disorder since the war. Switzerland, Holland and the Scandinavian countries kept out of the war, but willingly or unwillingly, their currencies have been devalued. Great Britain resisted stubbornly, but was dragged off gold through efforts to maintain the standard in Europe. The United States, although in the strongest position of any, has devalued the dollar 41 per cent.

With Great Britain off gold after 1931, and the United States following in 1933-34, the pressure upon the remaining gold bloc countries, i.e., Belgium, Holland, France and Switzerland, was doubly severe. With the mint price of gold in the United States up from $20.67 per ounce to $35, all of these countries were losing gold in streams. In March, 1935, the drain on the National Bank of Belgium caused a cabinet crisis and a devaluation of the currency by 28 per cent.

This action of Belgium made the French situation more difficult. Already the French franc had been reduced from its pre-war value of 19.3 cents in United States money to 3.92 cents. Thus the franc had lost nearly four-fifths of its pre-war gold value and more of its purchasing power. The official index of wholesale prices in 1920, based on 100 for 1914, was 510 in terms of currency and 184 in terms of gold. In 1928 the currency index was 645 and the gold index 141. From 1929 both indexes fell in every year to 1935, when the currency figures were 338 and the gold figures 68.

Wages had risen as money depreciated and the cost of living increased, but did not decline proportionately as prices fell. The disruption of trading relations reduced the volume of business, with resulting unemployment and increasing loss of purchasing power. With home trade declining, exports also fell from 50,139,000,000 francs in 1929 to 15,495,000,000 in 1935. Tourists' expenditures fell from 8,500,000,000 in 1929 to 800,000,000 in 1935. Railway traffic declined 40 per cent and the railway debt increased more than 20,000,000,000 francs.

Figures alone can give but slight idea of the disorder and distress resulting from this downward pressure of prices towards the pre-war level. All nations passed through like experiences, but with little understanding that the fall of prices was a natural reversal of the wartime rise, and part of the cost of the war. The first paragraph of the following extract from our August, 1937, article describing conditions in France, would apply to other countries as well:

> Wage-rates generally remained near the inflation level, but work was "spread" and actual compensation was low on the average, because of idle time. Agriculture was in distress, for despite the tariff protection the low-priced foreign products came in and beat down home prices to below the normal level, while the farmers paid twice over for everything they bought. The farmers became so belligerent that the Government granted direct subsidies upon the chief farm staples, which, of course, increased the cost of living to city dwellers.
>
> It tells something of the perplexities of this time that France had seventeen premiers and cabinets, from July 26, 1929, when Poincare retired, to the election of 1936; and all sought to restore the equilibrium by reducing costs and prices * * * To reduce the costs of government, ministries cut both government salaries and pensions, and to reduce the costs of living they regulated prices and wages in private industries and trade, to an extent perhaps never before attempted in a democracy. Price-fixing decrees were issued by scores, and Premier Laval was quoted in 1935 as saying that he would regulate anything from "sardines to cement."

Violent economic changes inevitably have political repercussions. A general parliamentary election came on in May, 1936, and popular discontent was afforded a vent. A slashing campaign was waged against monopoly, tyranny, unemployment, high cost of living, etc., and in behalf of higher wages, shorter worktime, vacations with pay, etc., with the result that the "Front Populaire" came into power, headed by M. Leon Blum, leader of the Socialist party. This victory was followed by a further lessening of production, a further rise of costs and prices, and a further decline of French exports.

With the Bank of France rapidly losing its reserves, the currency situation was critical, and the new Premier appealed to the Governments of the United States and Great Britain to join in a "tripartite agreement" for the "establishment of a lasting equilibrium between the various economic systems," the meaning of which was that it was desired to devalue the franc without provoking retaliation. This co-

operation was agreed to, and the unit franc was devalued again, on a sliding scale, down from 65.5 milligrams of standard gold to between 43 and 49 milligrams, the exact amount to be determined later. These figures would correspond in value to 4.35 cents and 4.96 cents of the new United States standard.

The good faith of the French effort to support the Tripartite Agreement has not been questioned, but as a triplicate standard it never had a chance. Costs and prices in France continued to increase, industry and trade languished, the adverse trade balance increased, and the cost of living index advanced from 497 in May, 1936, to 606 in May, 1937. The franc had fallen from 6.63 cents, new United States standard, to less than 4 cents, by mid-Summer the stabilization fund was exhausted and the Treasury was short of funds. The Blum ministry resigned and was succeeded by one headed by M. Chautemps, with Georges Bonnet as Minister of Finance. The new regime made a brave attempt by new taxes and loans to stabilize the franc, and it revalued the Bank of France gold at 4.35 cents, the minimum rate of the 1936 law, for the relief of the Treasury.

Despite excellent work, the Chautemps ministry lacked the support required to establish the franc on a firm basis. The industrial situation failed to improve, and on March 10, 1938, Premier Chautemps resigned and M. Blum was given opportunity to offer a new program. After proposing a capital levy he was voted out by the Senate.

Meantime, the industrial and political situations were increasingly alarming. A sit-down strike movement had stopped 180 plants in the Paris area, with 150,000 workmen, many of them engaged upon war equipment for the French Government.

The Daladier Government

The Parliament turned to M. Daladier, a former war minister and premier, who, addressing the Chamber, made a powerful appeal for a unified France and a gospel of salvation by more work and less politics. He said of his policy:

> The basic idea of the plan is to stimulate French production. In practically all departments French output is substantially lower than that of most European Powers. The necessary equilibrium can be achieved only through work. And the plan must, therefore, remove all obstacles to an indispensable increase in production, without which there can be no recovery.

The Paris correspondent of the London Times, in reporting this, added the following comment:

> The announcement that the Government's financial programme gives pride of place to the problem of industrial output has been received with general satisfaction. As a political observer said today, France, which is still one of the richest countries in the world, has been living for some years under a regime of artificial scarcity and self-inflicted poverty due to "short time" and an almost complete absence of capital investment. In such circumstances the country can support the present level neither of social charges nor of rearmament. The only remedy is to raise industrial activity at least to the level of that prevailing in the United Kingdom.

Parliament granted the new ministry authority to govern by decree for three months, all decrees to be submitted for ratification within the year, and upon this action the Chamber of Deputies, despite its Blum majority, voted 508 for to 12 against. The Socialists, moved, it was said, by the gravity of the foreign situation, voted 58 to 43 to give the Daladier Cabinet a trial but a news report says that "Daladier was cheered by the Center and Right, but the Left listened in chilly silence."

The first decree was to raise taxes 8 per cent, and one of the earliest was to devalue the franc to an exchange value of 179 to the pound sterling, or approximately 2.79 cents, present United States standard. The new premier, speaking to the nation over the radio, referred to financial difficulties confronting him as follows:

> Financial difficulties were waiting my return. About these I owe it to you to tell the whole truth. Here it is. Our economic position is bad. Work is not getting its legitimate profit. Our commercial balance is weak. The statistics of production are a disgrace to our country. The budget is again in a deficit. The Treasury is in a position that the present government cannot tolerate.
>
> There can be no question in this situation of doctrine or experiment. Whether it be orthodox or audacious, generous or cruel, every measure that can directly aid public security is necessary and every measure that does not contribute to public safety is superfluous.
>
> But a solid starting base is necessary for any policy of lasting confidence. It is essential, first of all, to fix a monetary level that corresponds to our charges and that is not always put in question, and that places the franc secure from any repetition of the attacks to which it has been subjected during recent years.
>
> That is why, without concern for criticism, I have decided to carry out a retreat of our money and to stabilize it on a basis where it can be effectively defended.

He closed this earnest address with an announcement of a new loan, urging participation. He said:

> The rate that I have fixed for tomorrow will not be exceeded. Your savings can be invested in our new national money without fear of any new degradation and with belief in the increased value of this franc.

It cannot be doubted that the Premier of France will do everything possible to make good his assurance, but he cannot win the victory without the support of the French Parliament and the French nation. Each of the three preceding devaluations has been accompanied by similar assurances, but have only repeated the lesson that currency depreciation of itself is not a remedy for economic disorders.

The Government is alert to the danger. Simultaneous with the announcement of devaluation the Minister of the Interior issued a communique, saying:

> The government has decided to proceed to stabilization of the franc but this measure should in no way provoke any increase whatsoever in prices. On the contrary, it should assure their proper stability.

This is almost word for word with similar announcements in the past. Moreover, the police were simultaneously instructed to make lists of the day's prices, for comparison and for prosecution in cases of "unjust increases." On the other hand, Communist and Socialist organs are eagerly predicting that prices will rise, and that "the workers will pay the cost of devaluation," thus preparing to capitalize the inevitable. Their panacea is to *nationalize the industries.*

The Daladier Government is moving cautiously to win concessions from organized labor that will increase the national output and reverse the trend of living costs. Upon this issue both the Government and the franc depend. One proposal is to modify the present 40-hour per week law by limiting factory labor to 2,000 hours per year, which would average about 40 hours per week, but allow seasonal variations.

Temporary Effects

The act of devaluation has checked the flight of capital from France, and afforded handsome inducement for the return of capital that had been exported.

Thus the conversion of francs into dollars at 6.63 to the franc and subsequent conversion of dollars back into francs at 2.79 cents yields more than twice as many francs as the trader started with. The London Economist of May 14 gives a "rough guess" that by the middle of that week £100 millions sterling had been repatriated ($500,000,000), over one-half probably coming from London and the remainder divided about equally between the Continent and New York.

The present movement has flooded the Paris market with cheap money, and the French Treasury has promptly offered a 5,000,000,000 franc loan, which has been over-subscribed. The entire money market is eased, and, finally, the "covering" of "short" sales of franc exchange has provided a substantial reserve of pounds, dollars, guilders, etc., for the Stabilization Fund. Thus the "Treasury's troubles" are relieved for the present, but what of the future?

Under the French law each time the money is devalued the Bank of France reserves are revalued, and although the capital of the Bank is privately owned, all of the newly created gold francs, (made out of the old ones) accrue to the Treasury. In 1928 they amounted to 16,710,000,000 francs, which if kept until now might have been converted into $1,108,000,000 of the present United States standard, but were all applied on the debt of the State to the Bank; in 1936 the gain was 17,000,000,000 francs ($843,000,000), of which 7,000,000,000 ($347,000,000) were again applied upon loans to the State and 10,000,000,000 ($496,000,000) were allocated to the Stabilization Fund. The revaluation by the Chautemps Ministry in 1937 yielded a gain of 6,840,000,000 francs ($297,000,000). This was assigned to a fund for the support of Government securities in the public market. Thus in all, from 1928 to this date the equivalent of $2,250,000,000 has been taken from the Bank and used in great part to pay debts of the State to the Bank!

At the end of April, 1938, Bank of France reserves consisted of approximately 55,807,000,000 of the somewhat attenuated francs ($2,431,000,000) which at the new revaluation will become 87,114,000,000 francs, thus yielding a "profit" of 31,307,000,000 francs, ($873,000,000). How this will be disposed of has not been announced, but as the debt of the State to the Bank is approximately 43,000,000,000 francs, it is probable that it will be applied against this debt.

The Succession of Francs

Summarizing this review we give below the value of the several francs by both old and new United States dollars.

		Milligrams (.900 fine)	Old Dollar	New Dollar
"Pre-War" franc	1878 to June 25, '28....	322.58*	19.295¢	——
"Poincare" "	June 26, '28 to Oct. 1, '36	65.50	3.92 ¢	6.63¢
"Blum" "	Oct. 2, '36 to July 22, '37	49.00	2.93 ¢	4.96¢†
"Bonnet" "	July 23, '37 to May 5, '38	43.00	2.58 ¢	4.35¢†
"Daladier" "	May 6, '38...............	27.60‡	1.65 ¢	2.79¢

* The pre-war franc was a silver coin which circulated as a token piece. The figures given here correspond to the gold content named for the Poincare franc in 1928. The French standard was devalued slightly in 1878, when gold payments were resumed after the Franco-Prussian War.

† Rate of valuation of Bank of France gold reserves.

‡ Not fixed officially.

Note: At 2.79 cents the "Daladier" franc equals 42.1 per cent of "Poincare" franc, or 8.55 per cent of the "pre-war" franc. The devaluation since Sept. 26, 1936 has amounted to 57.9 per cent. The appreciation of gold equals 137.6 per cent in current francs as compared with "Poincare" francs. In terms of old dollars, the "Daladier" franc is worth $0.0165.

Where Are the Gains from Devaluation?

In the tenth year since France formally accepted the policy of monetary devaluation, the seventh since Great Britain yielded, and the fifth since the United States gave way—with all currencies of the world now scaled down, gold production increasing rapidly and gold reserves up 100 per cent since 1931—surely it is in order to ask, how much the situation has been eased by cheaper money?

Money is so plentiful in the chief markets as to be practically unlendable, but the state of industry, trade and employment is far from satisfactory. Even the commodity price level, chief subject of solicitude five years ago, is slumping badly. Clearly, something is wrong in trade, but devaluation is not a remedy.

The gold standard had its origin in barter — the giving of one service for another, and the barter principle is the basis of all sound trade today, but obscured by a fantastic idea that "money" is the source of purchasing power. Money is a facility of trade, but the only real purchasing power in the markets consists of the goods and services being exchanged. Unless they pay for each other, trade stops and unemployment spreads.

French factory workers have been pushing up hourly wages and shortening the work-time, forcing the franc down from 6.63 cents in 1935 to 2.79 cents in 1938, in the mistaken belief that they were winning victories over employers; but they have forced up the cost-of-living index from 483 to 680 in the same time, besides reducing French exports and increasing the number of unemployed.

One of the quotations given above refers to the absence of capital investment in France in recent years. The effectiveness of labor in supplying labor's wants depends upon the tools with which labor does its work. The humblest worker in France is benefited by the use of capital in every industry that supplies his wants. What would be the living conditions of the present population of France without railroads, machinery, steam power, or other capital equipment? The rural districts of France have been steadily losing population to the cities as the mechanical industries and trade have been developed.

The effects of the continued drain upon the Bank of France illustrate the aggregate loss of capital suffered by the nation. The Bank of France is the central depository of the French system. Each devaluation of the franc has marked down the value of every bank deposit in France and of all savings in the form of promises to pay francs. These resources are a part of the working capital of France, necessary to industry, trade and employment. The plight of the French railroads is another illustration. In large part they are owned by the Government, but for years have been operated at a loss and the deficits met by borrowing in the capital markets. This wastage enters into the cost of living of every family in France. Notwithstanding this example of nationalization, demands are now insistent that all industry shall be nationalized. In this case where would the Government borrow for the deficits?

Rayon Staple Fiber—A Short Cut to Self-Sufficiency

The production and use of rayon in the textile industries of the world made another phenomenal gain in 1937. Consumption of continuous filament rayon yarns increased over the previous year, as it has in almost every year since the beginning of the industry. The greatest gain, however, was the extraordinary increase in "staple fiber," which is rayon cut into short lengths for subsequent spinning into yarns on cotton, woolen, or worsted spinning machinery.

As will be seen from the following table, the world production of staple fiber was more than 600 million pounds in 1937, compared with 300 million the year before, and 140 million in 1935. In 1932, staple fiber production at 21 million pounds amounted to less than half of one per cent of total world rayon production; in 1937 it reached 34 per cent, and if German and Japanese plant capacity comes up to present plans, staple fiber may approximate one-half of the world rayon output in 1938.

World Rayon and Staple Fiber Production
(000,000 Lbs.)

Year	Japan	U. S.	U. K.	Germany	Italy	France	Total
Rayon Filament Yarn							
1913......		2	7	8		3	25
1922......	1	24	15	11	7	7	77
1929......	27	121	53	58	71	42	435
1932......	70	135	70	55	62	51	515
1934......	153	208	88	85	86	57	772
1935......	224	258	111	98	86	62	939
1936......	275	278	118	99	86	60	1,021
1937......	334	312	120	125	107	66	1,187
Staple Fiber							
1932......	1	1	2	6	9	2	20
1934......	5	2	3	16	22	4	52
1935......	14	5	10	38	68	5	139
1936......	46	12	26	95	110	6	297
1937......	175	20	35	220	156	11	622

Source: Textile Economics Bureau, Inc.

No other synthetic product, competing with a natural commodity, has ever approached this record of growth. It is one of the most striking of all the examples of the endless change that takes place in the industries and in trade, through the introduction of new products and new methods, growing out of scientific experiment and progress.

The New Fiber and Its Adaptability

Since staple fiber is chemically the same as rayon filament yarn, there can be as many types of staple fiber as there are of filament; lustrous and delustered yarn, coarse and fine denier, viscose, acetate, and cuprammonium. The fibers drawn from the jets are cut either "wet" while still in the coagulating bath, and then washed and bleached; or "dry" rayon filaments, already washed and bleached, are chopped into desired staple lengths. The product is marketed in bales, like cotton. Certain production operations have been shortened and filament jets of 3,000 and more holes installed; in continuous filaments only 20 to 225 hole jets are used. This is the chief reason for the considerable price difference. A pound of viscose rayon staple fiber sells, for example, at 25 cents, while the viscose yarn costs 49 cents.

The use of rayon in the form of short staple is by no means new. Germany mixed chopped rayon in textile fabrics in the last years of the World War. Waste rayon has been bought by American spinners, cut into short lengths and spun since the end of the war. But the product was at first uneven, with poor spinning or knitting properties and, in general, acquired a poor reputation. In the meantime, great improvements were made in rayon production methods, and all the improvements were applicable to staple fiber. Dulled and pig-

mented rayons made their appearance. Italy and Germany continued to experiment with short staple rayon, and when national self-sufficiency became the slogan of the day for political and economic reasons, almost overnight a new industry sprang into being.

Made clean and uniform, the cut rayon fiber has a wide adaptability. Depending upon ultimate use in a textile fabric, practically every property of this new textile material can be regulated beforehand. Its chemical composition determines luster, propensity to dyes, elasticity and tensile strength. The shape of the fiber, curling, the size and the length, along with the method of spinning and the construction of the fabric, influence the handle and the appearance.

Cut about 1½ inches long, rayon staple can be spun on cotton machinery; when longer, over 2 inches with a curl, it can be spun and finished like wool. It can be mixed with cotton, wool with which it blends with excellent results, silk, flax, or rayon filament yarn; it can also be used in blends of three fibers. All major textile branches are now employing staple fiber in a wide range of fabrics, from fine worsteds and light linen cloths to drapery and decorative fabrics. Used alone, staple fiber has interesting properties.

The principal drawbacks are diminished strength in a wet state, and in general poorer resiliency than the natural fibers. But through scientific research many of the former disadvantages have been overcome; and progress is continuous. Newer brands of staple fiber are said to be fit even for heavy industrial uses; others are reported to have water repellent properties. Germany has already developed about sixty different brands of synthetic fibers, some of which have high strength when wet.

Price and Competition with Other Fibers

Along with the improvement of the physical properties of rayon staple, better productive methods have lowered costs and prices. The price history of American viscose staple fiber (1½ denier, 1½ inch long) follows:

Date	Viscose Staple Fiber (cents per lb.)	Viscose Rayon Filament*
Jan. 1928......	60	1.50
Oct. 1931......	50	.75
Aug. 1932......	40	.60
Feb. 1934......	34	.65
June 1936......	28	.60
Sept. 1937......	25	.63
Jan. 1938......	25	.54
May 1938......	25	.49

*(150 denier, first quality, std.)

Last Summer the fiber came within the range of the price of "clearing" cotton obtained by Germany in barter deals. Considering that the shipping costs and the waste in spinning of cotton amount to 10 per cent or more and that staple fiber is clean and uniform, with small loss in the spinning process, the price differential between cotton and staple fiber has not been an obstacle to its development; while as compared with wool its use has resulted in great economies. Due to the fall of raw material prices, particularly of cotton, the competitive position of rayon staple in world markets may have deteriorated somewhat recently.

The relative position of staple rayon fiber among major textile materials in 1937 may be seen from the table below.

World Production of Important Textile Fibers
(In 000,000 Lbs.)

	1913	1929	1937
Cotton	10,560	12,702	18,480
Jute	3,940	4,180	4,070
Wool (Washed)	1,531	1,978	1,980
Hemp	1,210	1,170	1,790†
Flax*	1,625	1,340	1,713
Rayon Filament	25	435	1,187
Rayon Staple Fiber	......	7	622
Silk	64	134	127

†1936. *Flax in unfinished state.

The Use in the United States

In the United States staple fiber has won general acceptance because of its cheapness and its own desirable qualities, and because of the style effect it gives when used in combination with other fibers. The domestic production rose to about 20 million pounds in 1937 and another 20 million pounds were imported, chiefly from Japan, Italy and the United Kingdom. The potential market is, however, expanding, especially in women's wear lines where staple fiber is accepted as an innnovation enhancing the appearance of the material.

As will be seen from the table below, the combined use of synthetic fibers in women's and men's wear has already exceeded the use of wool.

U. S. Consumption of Textile Fibers in 1937*
(000,000 of Lbs.)

	Women's Wear	Men's Wear	Household	Industrial	Total	Per Cent
Cotton	750	650	725	1,505	3,630	83.0
Wool	70	140	114	30	354	8.1
Silk	50	3	1	......	54	1.2
Linen	14	8	14	......	36	.8
Rayon	230	46	20	5	301	6.9
Total	1,114	847	874	1,540	4,375	100.0

*After the Textile Economics Bureau, Inc.

Compulsory Use of Staple Fiber

However, the qualities which won the American market for staple rayon fiber hardly account for the extraordinary increase in its use abroad. The fact is that staple fiber was perfected at the most favorable time possible for its development. It permits a far wider use of rayon than was feasible when the product was available only as a filament yarn. It is, within its limitations, a real competitor of wool and to

a lesser extent of cotton, being one of the few synthetic competitors of the chief natural commodities which are both cheap and practical. Hence it has been a special boon to the countries, lacking wool and cotton of their own, which are striving to make themselves as independent of imported raw materials as possible; and they have made great efforts to develop its use. The trend toward self-sufficiency is world wide, but naturally is stronger in countries which are short of both raw materials and foreign exchange with which to buy them. Where these countries had the necessary capital equipment, scientific knowledge and manufacturing skill, it was inevitable that they should seek to reduce their purchases of cotton and wool by using rayon fiber, manufactured at home, instead. It is in these countries particularly that its growth has been phenomenal.

The three nations most interested in achieving self-sufficiency, Germany, Italy and Japan, accounted in 1937 for about 89 per cent of world output of staple fiber. Germany was the first one to adopt regulations requiring mixing of synthetic fibers in textile products. Her ability to supply last year about 30 per cent of her "clothing textiles" requirements from domestic sources was made possible by the expansion of staple fiber production to over 200 million pounds. Staple fiber accounted for almost 15 per cent of total German supply of "clothing textiles" in 1937, against 8 per cent for rayon, 11 per cent for wool and 49 per cent for cotton.

On the other hand, Germany is still deficient in wood pulp, the most important raw material necessary for the production of synthetic fibers, although she has been apportioning the annual cut of timber and, rather improvidently, "mining" her forests. The union with Austria will reduce her import requirements to about one half. Timber was one of the few raw materials of which Austria had an exportable surplus.

Staple Fiber to Ease Pressure on the Yen

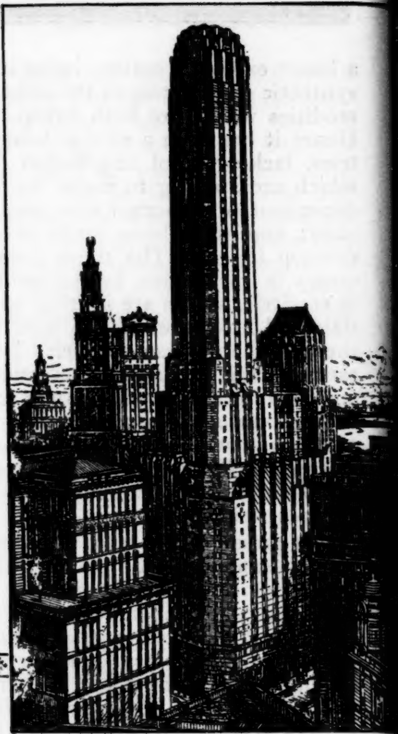
Japan, the third nation with an important textile industry to enforce the compulsory use of staple fiber, actually tabooed last November pure cotton and woolen fabrics for use within the country. Cotton fabrics must contain at least 30 per cent of synthetic fibers and woolen yarn or cloths from 10 to over 30 per cent. Under these measures synthetics are expected to replace at least 270,000 bales of foreign cotton per annum, as well as a considerable quantity of imported wool. By the use of rayon and staple fiber, cotton from North China, and wool from Manchukuo and Inner Mongolia, Japan hopes to clothe her own population with materials obtained wholly from within the yen currency area, reducing other imports of the textile fibers to the amounts which can be fabricated for export. That the policy, if successful, will ease the problem of meeting an unfavorable trade balance is obvious.

In line with national policy, the new capital control measures, regulating the internal distribution of capital within the Japanese Empire, afford preferential treatment to the rayon staple fiber industry. This assures the continuation of the boom of the industry which was launched in 1933 and last year turned out 175 million pounds. The Tokyo "Oriental Economist" has estimated that the combined rayon yarn and staple fiber installed capacity will reach, by the end of 1938, about 800 million pounds, of which about one-half or 400 million pounds will be staple fiber.

About 80 per cent of wood pulp consumed by the Japanese rayon and staple industries in 1937 was of foreign origin, with the United States leading as the source of imports. The cost, however, was only about 80 million yen as compared with 850 and 300 million yen spent for foreign cotton and wool respectively. Imported raw materials, according to the Japanese calculations, form only about 35-40 per cent of the total cost of production of staple fiber as against 60-80 per cent for cotton yarn. Through the importation of wood pulp in place of cotton and wool, Japan hopes to save annually about 160 million yen.

The development of staple fiber at this phenomenal rate is something to be considered by the sheepmen and cotton growers of this country as well as the silk farmers of Japan. Among the textile fibers competition and interchange is constantly occurring in some degree, influenced by price changes and style developments. The total poundage of rayon produced does not appear impressive in contrast with the poundage of cotton, and as the world use of fibers expands there will be room in the industries for both materials without necessarily reducing the actual consumption of cotton and wool. Nevertheless, price relations are affected. The higher the price of the old materials, the greater the competition from the new.

The Department of Agriculture is recognizing the influence of rayon in the long term price trend of other fibers. One of the arguments employed by Secretary Wallace against any effort to enforce the so-called parity price for cotton — approximately 16¢ a pound — is that the cotton growers not only would have to give up their export outlets, but that "at such a price competition from rayon and other fabrics would probably increase to a point which would make it impossible to pass into domestic consumption more than 7 million bales." The effect of rayon competition is felt in other countries at a lower price level than in the United States.



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